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February 21, 2003

TO: ISD and LEA Business Managers

FROM: Kathy Weller, Director, Office of Audits *Kathy*

SUBJECT: Changes in Auditor Independence Requirements Under Government Auditing Standards

The purpose of this letter is to alert you to changes in auditor independence requirements under the revised Government Auditing Standards issued January 25, 2002. This new standard is effective for fiscal years beginning on or after January 1, 2003; therefore, it is effective for the school year beginning July 1, 2003. The new standard for non-audit services is based on two overarching principles: (1) auditors should not perform management functions or make management decisions, and (2) auditors should not audit their own work or provide non-audit services in situations where the amounts or services involved are significant or material to the subject matter of the audit. Auditors of public school districts in Michigan are required to follow all Government Auditing Standards; therefore, you and your auditor will need to understand and implement these new standards.

To ensure that your auditor is in compliance with this new independence standard, contact your auditor and make arrangements to discuss all non-audit services the auditor has provided to the district in the past. Auditors are allowed to provide non-audit services that do not violate the overarching principles or the seven safeguards. Judgment by the auditor and the school district is necessary to evaluate the services provided under the independence requirements. One area of specific concern is the annual closing of the district's financial records. The auditor is precluded from closing the district's books and records and also completing the audit of those records. It is expected that the auditor will provide technical assistance (answer questions) and potentially identify "audit adjustments" that the district must consider recording. In addition, it is allowable for the auditor to assist the district in drafting the financial statements. However, the district must take responsibility for the ultimate content of the statements. There are provisions for exemption or "grandfathering-in" of non-audit services that were initiated, agreed to, or performed by June 30, 2002, provided that in all cases the work is completed by June 30, 2003. To ensure that you are prepared to handle the non-audit services your auditor may have done in the past, you should do the following:

- Review with your auditor the non-audit services currently being provided to the district.
- Determine if there are non-audit services the auditor will not be able to provide in the future.
- Determine which of these activities your staff can complete.
- For those activities that your staff cannot complete, make other arrangements.

The new independence standard is available on the U.S. General Accounting Office's web site at: <http://www.gao.gov/govaud/ybk01.htm>. The website also has an extensive *Answers to Independence Standard Questions* document.

Because of the nature of the change, it is likely some districts will need to do significant planning this year (especially as it relates to year-end closing procedures) in order to be prepared for the next fiscal year end and audit cycle.

Thank you for your attention to this matter.

c: School District Audit Firms

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